

ECONOMIC OUTLOOK

Chamber of Commerce of the United States

December 1984

THE HIGH GROWTH SCENARIO IS INDEED POSSIBLE

by Richard W. Rahn and Graciela Testa-Ortiz

In the October issue of ECONOMIC OUTLOOK we presented the Chamber's high growth scenario which showed how the national economy could move towards a balanced federal budget by the end of this decade. Our scenario asserts that, given the structural and cyclical changes which have already taken place in the U.S. economy, the right policy mix would propel the United States to a high economic growth path which would not only return the federal budget to balance, but would significantly enhance the quality of life for all Americans.

As background, let us review the path of the recovery so far (see Table 1). Using the past six recoveries as a guide (excluding the 1980-1981 recovery which only lasted twelve months), we can make several noteworthy comparisons between this expansion and previous cycles. Real gross national product has, so far, risen by 11.6 percent, on a par with the average experience. Media reports notwithstanding, the data show that this has not been a typical recovery fueled by high levels of government and consumer spending. While real consumer spending has increased at a rate consistent with past experience, its contribution to the increase in real GNP has not been impressive. More importantly, however, the rate of increase in federal government spending has been significantly below average, belying the notion that fiscal stimulus was responsible for the recovery's strength. Private investment, on the other hand, has risen at rates twice as fast as previous experience and almost three times faster than real GNP. This expansion, and the accompanying increases in employment and personal income, was generated in the private sector of the U.S. economy as lowered tax burdens on businesses unleashed a capital spending boom of unforeseen proportions.

TABLE 1
BUSINESS CYCLES
FIRST SEVEN QUARTERS OF EXPANSION
(percent change from trough)

Date	Real GNP	Real Fixed Invest- ment	Real Consump- tion	Real Govern- ment Spending	Manu- facturing Product- ivity
49:4-51:3	19.8%	12.5%	5.6%	84.2%	7.2%
54:2-56:1	9.7	15.0	10.1	-10.3	4.9
58:2-60:1	10.6	20.3	8.1	-4.6	8.8
61:1-62:4	9.5	12.8	7.9	11.5	10.3
70:4-72:3	10.0	18.9	10.0	-6.0	10.1
75:3-77:2	9.4	23.2	9.2	2.1	3.4
Average	11.5	17.1	8.5	12.8	7.5
82:4-84:3	11.6	32.4	9.0	2.1	9.1
% of GNP	100.0	279.3	77.6	18.1	NA
% of Avg.	100.9	189.5	105.9	16.4	121.3

NA: Not applicable.

Source: U.S. Chamber of Commerce, Forecast Section.

It is this increase in capital spending which sets the stage for high levels of economic activity in the years to come. Capital investment has not only increased in dollar terms, but also in quality. Competitive pressures, both domestic (as a result of deregulation) and international, have contributed to a major restructuring of the manufacturing sector resulting in a more efficient use of available capital and a stronger than average rise in manufacturing productivity. This, in turn, has in-

IN THIS ISSUE

The High Growth Scenario is Indeed Possible . . .	p. 1
Forecast Table	p. 3
Bringing the Federal Leviathan Down to Size . . .	p. 4
Lightening the Load of Regulation	p. 7
Privatization of Government Services:	
Improved Efficiency at Lower Cost	p. 9
Trends in Commerce	p. 11

Permission granted to quote from this report with appropriate attribution to the Forecast Section, Chamber of Commerce of the United States, 1615 H Street, N.W., Washington, D.C. 20062. \$7.50 per copy; \$60 per year.

creased the nation's productive capacity, making it possible to achieve rates of economic growth surpassing the economy's perceived potential, while at the same time being a major contributor to the moderate inflation environment we are now enjoying.

This is exactly the result which we had anticipated. For the past two years, we, at the U.S. Chamber, have been going against the popular wisdom in insisting that the 1981 Economic Recovery Tax Act had laid the basis for a strong, long-lived, noninflationary recovery based on strong productivity and investment growth. These results have proven conclusively that the U.S. economy is capable of the kind of growth for which we were branded as "too optimistic" when we predicted it in the past. Given that these higher than average improvements in manufacturing productivity and investment have already been achieved, we believe that policies can be enacted to ensure that the remainder of the 1980s become years of prosperity similar to the decade of the 1960s.

The purpose of our high growth simulation is to demonstrate how this outcome might come about, and to show that such growth can contribute to significant reductions in the deficit. Our scenario shows real gross national product growing by 47.2 percent between 1980 and 1989, compared to 47.5 percent in the 1960s. The relationship between GNP and its components would remain approximately the same as it has been during the past two years. That is, fixed investment is expected to grow two and one-half times faster than GNP, while consumer and government spending rise by only about three-fourths of the increase in real GNP (see Table 2).

TABLE 2
U.S. Chamber of Commerce
High Growth Projections
(percent change)

	1980-1989
Real GNP	47.2%
Fixed Investment	112.2
Residential	72.4
Nonresidential	123.4
Consumption	40.9
Government Purchases	38.0
Nonfarm, Business Productivity	30.4
Implicit GNP Deflator	54.1
3-month Treasury Bill Rate (%)	8.7 ^a
Unified Budget Deficit (\$B)	
FY 1989	-21.7
CY 1989	-3.0

^aTen year average.

Source: Modeling and assumptions by U.S. Chamber of Commerce, Forecast Section, using the Data Resources, Inc. long term, quarterly model of the U.S. economy.

The Congressional Budget Office, on the other hand, is forecasting a decade-long increase in real GNP of only 30.7 percent. In our view, this forecast is overly pessimistic. Not only is it significantly below the experience of the 1960s, it is also lower than anything we have experienced in the past three decades (see Table 3). Given the dramatic changes that the economy has undergone, we see no evidence to support their view.

TABLE 3
COMPARISON OF REAL GNP INCREASES
(percent change)

	Real GNP
1950-1959	35.0%
1960-1969	47.5
1970-1979	36.3
1980-1989	
U.S. Chamber of Commerce ^p	47.2
Congressional Budget Office ^f	30.7
Office of Management & Budget ^f	35.9

^pProjection.
^fForecast.

Source: U.S. Chamber of Commerce, Forecast Section.

This issue of the ECONOMIC OUTLOOK is devoted to an analysis of the policies which will make possible the attainment of the high growth goal. Our agenda for a vibrant economy emphasizes the major policy issues facing our country; namely, tax, spending and monetary policy, deregulation, privatization of government services, and free trade. The articles that follow concentrate on three of these six issues; namely, deregulation, privatization and federal government spending. The January issue of the OUTLOOK will address the remaining three key points.

This Month's Forecast

As we stated last month, we view the third and fourth quarters as a period of transition and expect 1985 to show a resurgence in economic activity. The third quarter numbers show the effects of continued large increases in imports and a pause in consumer spending. In fact, had there been no change in net exports from the second quarter; measured GNP would have increased by about six percent rather more than the 1.9 percent actually recorded.

Dr. Richard W. Rahn, Vice President and Chief Economist.
Dr. Ronald D. Utt, Deputy Chief Economist.
Ms. Graciela Testa-Ortiz, Director, Forecast Section.
Mr. Martin Lefkowitz, Director, Economic Trends and Statistics.
Dr. William Orzechowski, Director of Federal Budget Policy.
Ms. Rajni Bonnie Ohri, Economist.

TABLE I
UNITED STATES ECONOMIC OUTLOOK 1983-1986
 Prepared by the U.S. Chamber of Commerce

Percent change from previous period at seasonally
 adjusted annual rates unless otherwise noted.

	QUARTERS							YEARS			
	Actual		Forecast					Actual	Forecast		
	84:2	84:3	84:4	85:1	85:2	85:3	85:4	1983	1984	1985	1986
GROSS NATIONAL PRODUCT											
Real GNP	7.1	1.9	3.0	4.6	5.0	5.9	5.8	3.7	6.8	4.4	5.1
Consumption	7.9	0.6	4.4	4.3	4.3	4.4	3.9	4.8	5.3	4.1	3.8
Residential Investment	1.3	-4.5	-8.2	6.0	7.4	13.7	11.1	41.7	12.0	3.0	5.3
Business Fixed Investment	21.4	15.8	14.1	14.8	13.4	13.8	13.9	2.5	20.5	14.7	13.7
Equipment	21.2	19.6	14.6	15.1	14.0	14.6	14.8	7.3	22.3	15.6	14.7
Structures	21.3	7.0	13.0	13.9	11.8	11.5	11.6	-7.8	16.0	12.4	11.0
Exports	-0.6	8.8	8.5	6.5	9.5	8.1	11.5	-5.6	5.5	7.8	10.2
Imports	8.1	55.4	12.4	9.0	6.8	7.0	5.6	7.6	30.7	13.4	6.3
Government Purchases	18.6	6.4	7.5	1.9	3.0	2.8	1.1	-0.3	3.7	4.7	1.0
Inventory Change (\$ B)	50.6	68.5	50.9	48.6	44.1	46.3	50.7	-13.5	61.0	47.4	56.0
New Car Sales (mil. units)	10.7	10.3	11.0	11.1	11.2	11.4	11.5	9.2	10.6	11.3	11.8
Housing Starts (mil. units)	1.9	1.7	1.6	1.7	1.8	1.8	1.9	1.7	1.8	1.8	1.9
EMPLOYMENT, WAGES AND PRICES											
Unemployment Rate (%)	7.5	7.5	7.4	7.2	7.1	6.9	6.7	9.6	7.5	7.0	6.4
Compensation	3.7	3.6	4.1	6.5	5.4	5.7	6.6	4.8	4.2	5.2	6.8
Productivity	5.4	-0.7	2.0	2.4	3.1	2.9	2.6	3.4	2.9	2.4	2.5
Unit Labor Costs	-1.8	4.3	1.8	4.0	2.3	2.7	3.9	1.3	1.3	2.7	4.1
Consumer Prices	3.7	3.6	4.4	2.8	3.1	3.7	4.3	3.2	4.3	3.5	4.5
GNP Deflator	3.3	3.7	3.7	3.8	2.5	2.7	4.0	3.8	3.8	3.4	4.1
Prime Interest Rate (%)	12.3	13.0	11.4	10.5	10.0	9.7	9.3	9.8	12.0	9.9	9.5
Profits from Current											
Production (\$ B)*	195.2	197.1	200.4	208.3	214.7	218.9	218.9	149.4	194.3	215.2	218.3
GOVERNMENT FISCAL POLICY (\$BILLION)**											
Unified Budget—Receipts								601	667	756	830
Unified Budget—Outlays								796	842	940	1003
Unified Budget—Federal											
Surplus or Deficit								-195	-175	-184	-173

*Corporate profits after tax with inventory valuation and capital consumption adjustments.

**Unified Budget figures on a fiscal year basis.

Source: Modeling and assumptions by U.S. Chamber of Commerce, Forecast Center using the DRI macro model of the U.S. economy.

FORECAST ASSUMPTIONS

This month's forecast contains the Commerce Department's revised estimates of the national income and product accounts for the third quarter. It continues to take into account all the provisions of previously enacted legislation, including indexation of personal income tax rates, which becomes effective in 1985, and the Tax Reform Act of 1984. No additional fiscal policy assumptions are made. We assume that real defense spending grows by approximately five percent between 1985 and 1986, and that real nondefense discretionary spending is held in check. Monetary policy is expected to continue in its current conservative stance. The money supply, as measured by M1, is expected to grow at about the mid-point of its range. Crude oil spot prices have shown continued weakness despite OPEC's efforts to shore up prices through production cuts, therefore, this forecast assumes that the OPEC marker price of a barrel of oil is cut by \$1.50 by year-end. The price of imported crude oil then remains at about \$27.50 per barrel through 1986. A return to a normal harvest is expected next year so that wholesale farm prices will remain low. The federal minimum wage is assumed to remain at \$3.35 an hour through the forecast period. Sustained growth in foreign markets and partial exchange rate correction foster an acceleration in real export gains and slowdown in real import growth.

Amidst the generally lackluster economic news of the past few weeks, several encouraging notes emerge. The major good news item is the November decline in the civilian unemployment rate to 7.2 percent from 7.4 percent in September and October. Business investment remained strong in the third quarter continuing to post double-digit gains, and interest rates have eased substantially. Domestic automobile sales are inching their way back to the eight million unit level experienced prior to the General Motors strike, confirming that demand remains strong. According to our retail sales survey, expectations for the Christmas retail season remain healthy, seventy percent of the respondents expect retail sales this month to be higher than they were a year ago. Finally, despite the recent lackluster performance of new housing starts, we anticipate that the easing in mortgage interest rates will provide a second wind to the housing market. A recent HUD report shows that mortgage commitment rates on fixed-rate contracts are almost back to the 13.5 percent level of a year ago, and sales of existing homes held steady in October after five consecutive monthly declines. Coupled with continued high levels of business confidence in the economy's future, aggressive business spending plans, further declines in interest rates, and moderate increases in inflation, the outlook for 1985 and 1986 remains favorable.

Our forecast shows continued weakness in the fourth quarter as inventory build up slows somewhat. Continued easing of interest rates and strong residential and nonresidential investment growth rates should support 1985 and 1986 economic activity at a healthy level. Softness in world oil markets and farm prices, together with improved labor productivity will help keep inflation in check. In the foreign sector, some strengthening in the Western European economies, and a slowly declining dollar should improve U.S. exports. However, import demand is expected to remain strong throughout 1985.

BRINGING THE FEDERAL LEVIATHAN DOWN TO SIZE

by
William Orzechowski

For many, the nation's most pressing economic problem is the federal deficit. However, the remedies that are being put forward to deal with the problem are often worse than the ailment. For example, many claim that the federal budget offers little room for expendi-

ture cuts. Consequently, they embrace tax increases as a necessary component of a deficit reduction package.

However, the experience of other industrialized nations teaches us that tax increases do not solve the problem. Most of the Western European countries, for instance, have attempted to solve their budget deficit with round after round of tax increases. In the process, average taxes have been pushed to a whopping 45 percent of GNP. The result has been slow economic growth, escalating government expenditures, and rising, not falling, deficits.

The failure of tax increases to bring about fiscal responsibility puts the spotlight where it belongs: on the expenditure side of the budget. In the case of the United States, the truth of the matter is that there is plenty of room to reduce federal spending. In fact, it has been estimated that over twenty percent of the federal budget contains inefficient and extravagant programs.

Determining Budget Cuts

The federal budget is composed of thousands of relatively small items which together add up to a problem of massive proportions—a Leviathan of Lilliputs. This makes the job of cutting federal spending difficult since so many different programs have to be scrutinized. What is needed is a method to ferret out inefficient and extravagant programs since we do not want to cut programs for the sake of simply cutting the budget. That is, we do not want to hurt the truly needy or sacrifice important national security objectives. Nonetheless, there are sound economic reasons for reducing many federal programs.

In order to get a handle on these many spending programs, I propose a method to identify inefficient federal programs by scrutinizing them with relation to a hierarchy of four major criteria: program objectives, fiscal relevance, institutional alternatives, and administrative efficiency. Briefly, the objectives test is used to determine whether a program fulfills a genuine public goal by trying to establish if it has genuine public good characteristics, solves externality problems, and/or actually redistributes income. The fiscal relevance test estimates the benefits and costs of a program. The third test focuses on the most efficient institutional arrangements for achieving the program's goals. Finally, the last test determines whether or not the program is managed efficiently.

The intent of many federal programs is to finance the production of goods and services which are difficult to provide through the private sector because it may be difficult to collect contributions from beneficiaries. Unlike a private good, there is no way of excluding "free riders" from sharing in the benefits of public

goods. National defense is a good example. It is considered a public good because all citizens benefit from it. If national defense were to be financed totally by the private sector, it would not be possible to collect enough revenues. Those individuals who fail to contribute would still enjoy the national defense provided by the contributors. This problem can find a solution through government financing which forces all citizens to contribute to national defense through taxation.

However, there are many federal programs that do not meet this objectives test since they amount to the finance of private rather than public goods. In other words, they provide goods and services that the private sector could generate without a government subsidy. For example, many commodity price support programs and federal loan subsidies would not meet the objectives test. The commodity price support programs do not solve a public goods problem. Instead, they represent a transfer payment from consumers and taxpayers to farmers. Consumers must purchase farm products at higher than market prices, and taxpayers must pay the government's cost of buying agricultural surplus. Moreover, price supports mean that low income individuals must pay higher prices for basic necessities thereby increasing their dependence upon welfare programs such as food stamps.

In a similar vein, many federal subsidies and loan guarantees merely transfer wealth from the general taxpayer to special producer and consumer groups. These private goods could be financed in their entirety in the marketplace. Further, those private goods that do not generate an adequate market demand should not be produced at all since the resources involved in their production could generate higher value elsewhere. Yet the federal budget is riddled with many such cases. Urban development subsidies have been awarded for projects such as luxury hotels; the Rural Electrification Administration grants loans at five percent interest for rural electricity; and Amtrak lost close to one billion dollars while receiving subsidies that averaged about \$40 per passenger.

What is truly amazing is the amount of federal budget cuts that can be made on the basis of the objectives test alone. According to estimates by the Congressional Budget Office (CBO) and the Heritage Foundation, annual savings in excess of \$30 billion a year are possible. Moreover, such cuts would not deprive the poor of needed social programs since they often represent subsidies to higher income producer and consumer groups.

After passing the objectives test, the next test would focus on the relevance of a particular program. For example, a program may be associated with a public

good or it may help the poor, thereby passing the objectives test, but it could be, nonetheless, irrelevant. This occurs if the benefits of the program do not cover its costs. For instance, a program to arm soldiers with bows and arrows along with their rifles may contribute, by some degree, to increasing national security. However, the benefits of such a program would hardly cover costs. Likewise, the Comprehensive Employment and Training Administration (CETA), was designed to provide job training for low income individuals. While the program had an acceptable objective, it turned out to be a failure because of the small number of people who obtained permanent jobs as a result.

Unlike the objectives test, the relevance test can be difficult to implement since expertise is often required for a careful benefit-cost analysis of programs that are technical in nature. Nevertheless, it is the responsibility of government auditors to discover such waste. In the case of the defense budget alone, annual savings of this nature are estimated to be enormous, in the range of \$30 billion to \$40 billion annually. The defense budget is replete with many cases of weapons systems that are expensive but ineffective. Yet they remain in the budget because Congress and special interest groups benefit from their existence. This is borne out by the frustration of those technically trained individuals who, after locating such waste, are often ignored, ridiculed, and sometimes demoted.

The third test for screening federal budget programs focuses upon institutional arrangements. A program may achieve a reasonable objective and could be fiscally relevant, but the most effective way of implementing the program may require participation by the private sector or lower levels of government. Public mass transit is a case in point. These systems solve traffic congestion problems that are localized in nature. By placing these activities at lower levels of government, the direct beneficiaries of such programs would be required to finance them. This reduces the incidence of cross-subsidization, that is, the act of taxing the entire population for programs that provide local or regional benefits only. Moreover, locally-funded programs allow for greater competition in the supply of public goods. One such program is the San Diego rail line. It was recently completed ahead of schedule at one-tenth the cost of a similar system funded by the federal government.

There are several variations on the institutions theme, with many of these requiring greater participation by the private sector. Many proposals call for privatization in cases where actual production of the good takes place in the private sector, even though it is financed in the public sector. One important method allowing for public finance but private production is a voucher system. Other methods rely on various forms

of contracting-out and an assortment of bureaucratic reform.

Social Security is a classic case of improper institutional arrangement. Most retirees are under the illusion that the benefits they receive are equivalent to a market return on the amount of their past contributions. In reality, however, they are receiving benefits that greatly exceed a market return because vote-seeking politicians have mortgaged the future by continually boosting benefits beyond actuarially sound levels, that is, levels beyond which no private firm would have undertaken the program. The Grace Commission has estimated that today's typical Social Security recipient, over his lifetime, will receive benefits that are four times the total contributions made by him and his employer, plus interest on those contributions. Within two years, he or she receives benefits equivalent to the total of all past contributions. As a consequence, the Social Security system confronts serious long run problems that few politicians are willing to face.

This dilemma could have been avoided through proper institutional arrangements. When Social Security was conceived it strove to achieve reasonable welfare objectives through the installation of a retirement floor. This would benefit less fortunate individuals while at the same time requiring everyone else to put something aside for retirement. This retirement floor should have remained apart from any concept of a *quid pro quo* annuity plan. If welfare and annuity functions were split, individuals would have turned to the private sector for the bulk of their retirement needs. In this way a more responsible and efficient retirement system would have evolved.

Finally, the last test every federal program should pass is an administrative efficiency test. If a federal program has a reasonable objective, is fiscally relevant, and has been privatized and decentralized to an efficient degree, it should also be managed in an efficient manner. Managerial abuses are often the prime focus of budget cutters. Goldplating, overstaffing, contractor scandals, bureaucratic sloth, uncollected debts and obsolete military bases make interesting headlines. The Grace Commission is a testament to the monumental proportions of such waste. It reported over \$200 billion in savings that could be achieved in three years by improving administrative functions alone.

In summary, economic principles suggest a rather clear cut method for reducing federal government expenditures. A federal program should meet a legitimate public sector objective, its benefits should cover costs, it should be decentralized to an efficient degree, and it should be managed efficiently.

Room To Cut

Using the criteria developed above, reputable sources such as the Congressional Budget Office, the Government Accounting Office, the Heritage Foundation, the Brookings Institution, the Grace Commission, and the Senate Finance Committee, have located budget cuts that amount to close to \$200 billion in one year alone. This is more than twenty percent of the present budget.

A detailed list of these budget cuts has been assembled by Glenn Pascall in his forthcoming book, *The Trillion Dollar Budget—How To Stop The Bankrupting Of America*. Nearly all of the budget cuts suggested by Pascall trim back program waste and extravagance, reduce subsidies for private goods and services, and decentralize federal programs without jeopardizing national security or hurting the truly needy.

In terms of budget categories, approximately \$50 billion could be shaved from the defense budget alone. While we all recognize the need to strengthen national defense relative to other budget functions, there is, nonetheless, no need to fund the waste found in the military budget. For example, military commissaries were originally established to provide low cost goods to soldiers in frontier areas. Yet, today we find commissaries in such frontier towns as Norfolk, San Diego, San Francisco, and Washington, D.C. The Grace Commission estimated that in order to make the military retirement system solvent, an annual levy on payroll of 118 percent would be necessary. In the private sector, on the other hand, the levy is 14 percent of payroll. In 1969, the Nixon Administration proposed closing 307 obsolete military bases. Today, fifteen years later, nearly all of them remain in operation. Essentially, most of the defense cuts involve the reduction of weapons systems that are fiscally irrelevant or cost-ineffective, the removal of waste through more competitive procurement procedures, and the disposal of unneeded facilities.

There are vast opportunities for reform in the entitlements area, as well. Proposals for budget cuts spanning Social Security, Medicare, and the Civil Service and Military Retirement systems, can easily add up to over \$50 billion in savings. For instance, the Social Security benefit formula can be adjusted to curb some of the program abuses of the past without placing undue hardship on retirees. A one year freeze on cost of living adjustments (COLAs), coupled with a COLA set at sixty percent of the increase in the Consumer Price Index (CPI), can save over \$20 billion in 1989 alone. Aside from the savings, this change in the benefit formula would provide a measure of equity to the system, since sixty percent of the CPI is the average cost-of-living increase received on private pensions that

are indexed to the CPI. Savings in the Medicare program are made possible through greater co-payments by program beneficiaries who are presently receiving mammoth subsidies for short term hospital stays. Some of the flagrant abuses found in the Civil Service and Military Retirement systems, where unfunded liabilities stand at a colossal one trillion dollars, can be curbed by making them comparable with private pension plans. There is no reason why military and civil service personnel should retire with pensions at the ripe old ages of 40 and 55, respectively, while their private sector counterparts retire with less generous net benefits in their middle sixties.

Finally, over \$55 billion in budget cuts are available in other areas of the budget, primarily in the domestic discretionary programs. These cuts run the gamut from repeal of the Davis-Bacon Act and reduction of agricultural price supports, to re-assignment of regional activities to state and local governments. In general, the theme is for a more efficient government through elimination of federal subsidies for private goods and greater fiscal decentralization.

Summary: A Budget Cutting Strategy

Painstaking research by reputable institutions reveals what is common knowledge—the federal budget is severely bloated, and there is plenty of room to cut it further. There is no need for tax increases of any kind. What is needed is the political will on the part of the Administration and Congress to bring about the necessary spending cuts.

In this regard, the U.S. Chamber has taken the lead in developing a federal budget plan that will move the budget towards balance without relying on any tax increases. This federal budget plan will be the cornerstone of a business coalition that includes the Chamber and other major business associations. In this way the business community will be united in a lobbying effort to bring about a significant reduction in the growth of federal expenditures.

The business coalition's federal budget plan will be presented in the format of a modified budget freeze. For the most part, the plan strives to reduce expenditures on a proportionate basis. It bundles many of the budget cuts enumerated above into one large package that is spread across all budget functions. In this way, a lot of cuts are made at once and none sticks out from the rest, thus creating a sense of fair-share sacrifice. No one group can claim that the budget is being balanced on their back. The results are dramatic. With one plan under consideration, the deficit falls to \$13 billion by 1989. The effect is all the more surprising when it is realized that this plan uses only a portion of the cuts suggested above.

LIGHTENING THE LOAD OF REGULATION

by
Rajni Bonnie Ohri

Four years ago, the Reagan Administration announced a four part program to revitalize the U.S. economy. Regulatory reform was presented as part of that plan. During 1980, Reagan pointed out that for businessmen faced with a multitude of regulations, the compliance costs are much like a tax. Sweeping regulatory reform was seen as a significant means to stimulate production by reducing costs and improving cash flow in the short run, and to improve productivity in the long run. Recognizing the far-reaching costs of inefficient overregulation, Reagan argued that a government interested in encouraging economic growth ought to impose only those regulations where benefits exceed costs, and ought to administer these necessary regulations as efficiently as possible.

The added costs of regulation have far-reaching effects and are eventually translated into price increases. Automobile safety and emissions control devices added an average of \$600 to car prices in 1978. American steelmakers face a competitive disadvantage because compliance with pollution abatement regulations pushes domestic prices up over \$8 dollars a ton. Buyers of new homes pay over \$2,000 more so builders can meet government construction requirements. Spokesmen for textiles, chemicals, transportation, energy and other industries charge that regulations lower productivity and growth in their industries.

Indeed, Wayne B. Gray, author of *The Impact of OSHA and EPA Regulations on Productivity*, finds that more than one-third of the productivity slowdown in manufacturing industries was the result of increases in government regulations on health, safety, and the environment. Gray estimates that these regulations reduced productivity growth in the manufacturing sector by 0.57 percent annually and lowered manufacturing output in 1978 by \$13 billion. He compared the rate of productivity growth in the 1973-78 period to the experience in 1958-69 and found that those industries which spent the most to comply with government regulations introduced after 1970, suffered the largest declines in productivity growth.

The net benefits of deregulation are just beginning to have a lasting impact on the economy. Long-distance airline fares, adjusted for inflation, have declined by almost fifty percent in the last seven years. Many trucking rates have been lowered by thirty percent in real terms since 1980. Between 1982 and 1983, the cost

of standard telephones fell by one-third. And, for small investors, the cost of buying stock is sixty percent lower as discount brokerage firms have proliferated.

Early Years of Regulatory Reform

The current regulatory reform movement, which began in the Ford Administration and gathered steam under President Carter, was initially concerned with erecting new institutional constraints on the costs that regulatory decisions imposed on the economy. Both Administrations attempted to tackle regulatory reform by adding on another layer of regulation that replicated the original problems. President Carter expressed his concern regarding regulatory reform by establishing a Regulatory Analysis Review Group, a Regulatory Council, and by issuing Executive Order No. 12044 on Improving Government Regulation, which broadened the requirement for economic impact analyses.

Under the Ford and Carter Administrations, progress towards the deregulation of airlines, trucking, railroads, energy, telecommunications, and banking created the notion that government regulation was entering a declining phase. The facts, however, support the reverse view. In 1977, the Environmental Protection Agency (EPA) imposed by far the heaviest regulatory burden on the economy, accounting for over \$2 billion in regulatory costs to the business community. Certain regulations were found to be especially burdensome while others imposed relatively small costs. To illustrate the former, two Acts, the Control of Air Pollution from New Motor Vehicles and the National Ambient Air Quality Standard for Particulates accounted for over \$900 million of incremental costs in 1977. The impact of regulation also showed a wide variation among industries. For example, the incremental cost of the Occupational Safety and Health Administration (OSHA) rules averaged \$6 per worker per year in the banking industry, but \$220 per worker per year in the chemical industry. In several instances, regulations were found to conflict with broad national policy, as seen by EPA regulations which encouraged the increased use of oil, particularly low-sulfur oil, adding to U.S. demand for foreign oil and straining the country's balance of payments.

In addition, these regulatory burdens and others contributed to rising inflation, low productivity growth, and lagging economic growth which characterized the late 1970s. Three quantitative measures of this phenomenon can be cited: Douglas Costle, former administrator of the EPA, figured that his agency's regulations raised the consumer price index in 1978 by about 0.4 percent. Edward Denison of the Brookings Institution, calculated that expenditures on health and safety regulations, environmental protection, and crime prevention resulted in a 20 to 25 percent decline in productivity growth in 1975. And Murray Weiden-

baum's study for the Joint Economic Committee estimated that the total cost of regulation was \$103 billion in 1979.

Current Regulatory Reform

President Reagan addressed the problem of regulatory reform by creating a Presidential Task Force on Regulatory Relief and charging it with the responsibility for bringing the federal bureaucracy under control. He also established a formal regulatory review process to ensure that federal agencies would not overstep their bounds. The principles the President announced for guiding the Task Force and the agencies are: the federal government should not regulate unless there is demonstrated need; it should ensure that the benefits of regulation exceed the costs; and it should be sure it has chosen the most cost-effective solution that places decision-making authority with the most responsive unit of government.

In reports prepared by the Task Force, the achievements of this Administration make for impressive reading: new rule-making has been cut by one-half; the number of pages in the Federal Register has been reduced by one-third; paperwork for 1981 was cut by 200 million man-hours; \$9 billion to \$11 billion in one-time investment costs as well as \$6 billion in annual recurring costs have been saved.

The Administration has also issued new rules and reviewed existing ones: it has cut back federal intrusion into local decision-making, such as the Department of Education's dress code regulation; it has eliminated red tape, such as the multi-level permit review system; and it has rescinded counter-productive policies, such as the EPA regulations inhibiting the construction of new, cleaner plants. The Task Force has targeted more than one hundred major regulatory programs for review and modification, paying special attention to the regulatory problems of small businesses, local governments and other groups that lack highly paid lobbyists or representatives to tackle the federal bureaucracy. Their efforts have saved state and local governments between \$4 billion and \$6 billion in total investment costs, and \$20 billion in annual costs over the next decade. The actions range from issues such as rescinding the previous administration's multi-billion dollar requirement for bilingual education in schools, to lifting Department of Labor restrictions on home-work in the Vermont textile industry, allowing workers there the choice of staying at home knitting sweaters rather than be obliged to work in a factory.

While the President and his aides certainly deserve praise for what has been accomplished, the job has only just begun. In reaching these accomplishments, the Administration relied primarily on tools that yield only transitory results. Many legislative enactments man-

date unrealistic goals or unreasonable methods for social regulation and need to be revised. Such onerous regulation ranges from the "zero discharge" goal of the Clean Water Act to the "zero risk" provision of the Delaney Amendment of the Food, Drug and Cosmetic Act. Thus, if this Administration expects to leave a lasting legacy of true regulatory reform, they must direct their attention during the next four years toward achieving statutory changes in the many laws that provide mandates to the regulatory agencies. The regulatory statutes under which many agencies function were drawn up long before technology and a changed economic environment brought competition to many industries, and they may now require change.

The Regulatory Challenge

The move to deregulate, which began slowly just a decade ago, is gaining force throughout the economy. By reducing government regulation, the nation is revitalizing three basic industries—transportation, finance and telecommunications—and boosting the economy as well. As deregulation takes hold, this segment of the economy is experiencing a burst of competition which is encouraging innovation, increasing productivity, and reducing prices.

Transportation, telecommunications, and the financial system are critical components of the country's infrastructure. To be sure, there are short-term costs from the deregulation of these industries. Airlines, trucking companies, and banks have failed. Adjustment in the airline industry has been hard, including the failure of some major airlines, witness the case of Braniff. The result has been the largest losses in airline history—\$1.4 billion from 1980 to 1982. Trucking deregulation, which hit the industry in 1980, has had a harsh impact as well. Price-cutting, the entry into the industry of thousands of new trucking companies, and the 1981-82 recession put more than 300 trucking companies out of business. Rising costs of deposits and keener competition have cut into bank profits, weakening some banks. Seventy banks have failed this year, and regulators have nearly 800 others on the "problem list."

But these costs must be measured against a broader backdrop. For example, 10,000 small new operators have entered the trucking industry, and 14 new airlines have been launched since 1978, when Congress eased entry and granted more pricing and route flexibility. After years of decline, railroads are finally making a healthy rate of return on investment. The financial industry is also treating the public to an explosion of products and services offered by a growing number of new institutions. Deregulation has brought unparalleled opportunities to many companies plus lower costs to consumers. Those lower costs have contributed to the slowdown in the inflation rate and to a pickup in labor productivity.

Labor costs in the deregulated sectors are also being slashed. Although separating the effects of recession is difficult, deregulation is seen as a major contributor to the continued decline in the rate of growth of labor costs, what Marvin Kosters of the American Enterprise Institute calls "disinflation in the labor market." Nowhere is that more evident than in the transportation industry, where both airline and trucking unions have accepted wage cuts and more flexible work rules.

Conclusion

The economic case for reducing government regulation in the marketplace is, of course, different from the political one. Deregulation as a political possibility began to take shape during the Ford Administration, followed by a strong commitment under President Carter. Some gains were made during this Administration's early years as well. Now, however, signs of weakening political will are becoming increasingly evident.

When this Administration took office, a number of strong actions in regulatory reform occurred in its early months. Since then, however, the momentum appears to have been lost. What seemed to be a clear sense of direction has given way to a disappointing drift. Murray Weidenbaum claimed that the objectives of regulatory reform should be to do a better job of achieving regulatory goals while reducing regulatory burdens. For some areas of regulation, the best way to attain these objectives is to dismantle regulatory structures and rely on competition. For other areas, however, some form of regulation is called for. In those cases, agencies should avoid regulations that are either inefficient or too costly compared to the benefits they achieve, while establishing policies to deal more effectively with the problems that gave rise to the regulatory programs in the first place. The goal of regulatory reform is the same in both areas—to achieve improved overall economic efficiency.

PRIVATIZATION OF GOVERNMENT SERVICES: IMPROVED EFFICIENCY AT A LOWER COST

by

Graciela Testa-Ortiz and Frank Sellers*

Adam Smith's greatest legacy to the development of economic thought was the concept of improved efficiency through specialization and the division of labor.

*Frank Sellers is Director, Business Alliance on Government Competition, Business Government Policy Division.

Today, we are unlikely to give the division of labor a second thought. Nevertheless, we still have the choice of, for instance, making our own clothing, furniture, household repairs, etc., or having someone else do it for us. In general, however, we find that it is a more efficient use of our resources, including time, to buy someone else's services. In so doing, we usually shop around for the best quality and price.

Similarly, the government, at all levels, has the same choice, namely, to do things for itself, by hiring government employees to perform the necessary functions, or to contract with a private sector supplier of the required goods and services. For example, to maintain the beauty of its parks, a locality can hire and train the necessary personnel, or contract with a local landscaping firm to do the same job. There are two ways of transferring public functions to the private sector. One is through contracting-out, where the work is performed by a private sector firm but the government maintains the ultimate responsibility for overseeing and planning. The other is acquiring the goods and services from the private sector without any actual government involvement in the production process, as for instance, when the government buys paper clips.

The evidence on the private versus public production of services required by all levels of government shows that the private sector can meet many of the needs more efficiently and in a more cost-effective manner than the public sector. The National Oceanic and Atmospheric Administration (NOAA) recently found, for instance, that it could save \$1.8 million per year by hiring a private firm to warehouse and mail out nautical and aeronautical charts. NOAA had been spending \$2.8 million annually to do the same work with federal workers.

To some observers, the ability of the government to keep abreast of the needs of the country are at question. The remainder of this decade and the decade of the 1990s will be years filled with fast-paced technological change in the private sector, but the federal government is limping along with 1960s technology. The Defense Department cannot keep track of its spare parts inventory and throws away new spare parts at one end of its supply system while it buys the same parts on the other end; the Social Security Administration cannot keep its computer banks up-to-date and needs a total revamping of its system; and other examples keep arising.

Who better is there for the government to turn to in seeking ways to cope with the increasing pressure for up-to-date information and technology than the sector of the economy producing that technology: the private sector? More of the same has put the government

where it is today. The direction has to change. The types of activities involved include seeking private sector services for computer software; independent laboratory and testing; research and development; architecture and engineering services through CAD/CAM or computer-assisted design and manufacturing; systems integration and support activities; telecommunications development; accountants, lawyers, food services, etc.

Steve H. Hanke, a former senior economist on the Council of Economic Advisers, testified before the Senate Small Business Committee earlier this year that, *"Excluding postal workers, more than one in every four federal employees is engaged in commercial activities . . . The commercial activities performed by the federal government are very wasteful, and could be performed at a lower cost in the private sector."* Savings have already been realized in situations where there has been a transfer of commercial activities to the private sector. For instance, the Department of Defense has identified \$250 million in savings which reoccur annually through the contracting out of 235 activities that were previously undertaken with public sector employees.

There is an important difference, however, in the degree of reliance in the private sector and the savings that could be achieved as a result. A significant amount of contracting-out of small-scale, one-time projects is already taking place. However, this differs significantly from a more total reliance on private initiative, which in some cases would entail the dismantling of legal monopolies currently in existence.

Recent examples of private initiative in areas long viewed as the exclusive domain of the government suggest that privatization opportunities are much greater than previously believed. Private competition with the postal service offers a dramatic example of the savings that could be achieved. Indeed, it is readily apparent that the keen competition between private parcel carriers, such as Federal Express, United Parcel Service, and others, is resulting in improved service and lower costs for consumers. Private electronic mail also offers an alternative to the postal service. However, the postal service remains a legal monopoly, even as the evidence accumulates to show that postal services could be handled more efficiently in the private sector. A recent example is the case of a private postal service in Utah that was charging 15 cents to mail first-class letters. REACT Postal Services Inc. offered consumers the same type of discounts for pre-sorting that are routinely available to businesses. Because most of the letters that consumers send are to pay bills, and these go to a small number of addresses, REACT could combine hundreds of small envelopes into a large package and mail 4,000 bills for \$35, whereas the separate postage on individual letters would cost \$800.

At the same time that the firm was offering these lower cost services to Utahans, it was making a profit of about 10.8 cents per letter. The American Postal Workers Union brought a suit against REACT charging the company with decreasing Postal Service revenues and undermining the legally protected postal monopoly. Unfortunately for Utah consumers, the suit resulted in an injunction against REACT.

Another area where one would least expect to find private enterprise thriving is corrections facilities, such as jails, halfway houses, and detention centers for juveniles and undocumented aliens. Private companies now operating in several states can not only build a jail, but also administer it, hire and train guards, provide meals and the personnel to run rehabilitation and drug-abuse programs, and even arrange financing for the project. Reports state that private companies can perform these functions at a lower cost than the government—about \$10 less per inmate per day—while still showing a profit.

Unfortunately, even as the evidence on the benefits of privatization continues to increase, the federal government has taken some backward steps in major areas where research and innovation are occurring very rapidly in the private sector. It was recently revealed that the Department of Defense is creating its own Software Engineering Institute to develop the necessary computer software for weapons systems.

Urban mass transit provides an example of the costs involved in reversing the trend towards privatization. Whereas in the early post-war years a majority of urban transit operations were privately owned, local governments have increasingly taken on urban mass transit as their exclusive domain. The result has been large, expensive systems, with relatively low ridership rates. Why has this occurred? The preponderance of public transportation systems has afforded transportation workers with a virtual monopoly. As labor costs have risen, the systems have increasingly substituted capital for labor, and reduced the frequency of service. The result has been that instead of buses running a route, say ever ten minutes, we now have larger buses and/or trains running every fifteen or twenty minutes. This inconveniences riders who turn to other transportation methods, reducing revenues even further. Many suburban routes, for instance, could easily be served by private companies using smaller buses. Instead, what we typically see are large, expensive buses with very few riders.

Moving public functions to the private sector not only contributes to reducing the deficit through the savings that would accrue to the government, but also results in higher government revenues, increased productivity, and higher economic growth. When a private

firm, rather than public employees, perform a commercial activity, revenues are returned to the states, as well as the Federal Treasury, in the form of taxes (such as social security, unemployment, sales, corporate income, property, and fuel taxes), and user's fees (such as licenses and highway use). The employment of government workers, on the other hand, returns revenues only in the form of social security and unemployment taxes. An Oregon study recently concluded that taxpayers receive a net return of more than 20 percent of the contract cost when construction projects are undertaken in the private sector. While a similar study in New Jersey concluded that a firm of 200 employees and an annual gross income of \$10 million in government contracts would return \$1.2 million annually in taxes to the three levels of government.

Clearly, the examples shown here only scratch the surface. There remain tremendous opportunities for greater savings from moving many commercial activities currently performed by the federal, state, and local governments, to the private sector.

TRENDS IN COMMERCE NOTES ON TABLE II

December 1984

Gross National Product (GNP) - The Department of Commerce preliminary estimate for economic activity in the third quarter of 1984 indicates that GNP—the value of the nation's output of goods and services—grew at an inflation-adjusted 1.9 percent annual rate, a significant downward revision from the earlier estimate of 2.7 percent growth. The third quarter growth rate is a significant slowdown from the the first half of 1984 when GNP was growing at an 8.6 percent annual rate. The lower third quarter growth rate reflects a 0.6 percent rate of growth in personal consumption expenditures compared to 7.9 percent in the second quarter. Business fixed investment was revised upward and grew at a 15.9 percent annual rate, the fifth consecutive quarter of double digit investment growth. Government purchases increased 6.4 percent and residential investment declined at a 4.6 percent annual rate.

Money Supply - The nation's money supply—as measured by M-1, currency in circulation plus demand deposits—decreased by 0.6 percent in October. This resulted in a 0.1 percent decline in the money supply in the latest three month period. This performance places the nation's money supply well below the target growth range of four percent to eight percent established by the Federal Reserve Board earlier this year, and below the six percent growth target set by the

Federal Open Market Committee at its October 2 meeting. The money supply has been sluggish since June. However, the Fed, in fear of slowing down the economy too fast, has eased up significantly since early September.

Employment - Civilian employment—as measured by the monthly survey of households—jumped by approximately 300,000 persons (seasonally adjusted), in October to 105.9 million, bringing the employment increase for the first nine months of the year to three million. The establishment data indicated that American businesses have hired over one million new workers since June. The U.S. economy has created nearly seven million new jobs since the end of the recession in November 1982. The civilian unemployment rate declined in November to 7.2 percent, from 7.4 percent in September and October.

Prices - The Consumer Price Index for all urban consumers (CPI-U) rose 0.4 percent in October, for the second month in a row. This follows a 0.5 percent increase in August. The October increase was due to a rebound in food prices which had declined in September, and an increase in gasoline prices. Smaller increases were also reported for the apparel and housing industries. The consumer price index has increased at an annual rate of 3.7 percent in the last six months and 4.2 percent from its year-ago level.

Wholesale prices of finished goods declined 0.2 percent in October. This was the third consecutive month of decline for the index which is composed solely of goods, and does not include services which are a part of the consumer price index. The wholesale price index is now 0.2 percent lower than it was six months ago, and only 1.4 percent higher than its year-ago level. The October decline was largely due to declines in the indices for cars and trucks as prices for newly introduced 1985 models were lower, after seasonal adjustment, than the September closeout prices. In contrast, finished energy goods prices turned up after several months of substantial declines. Prices for finished energy goods in October remained 5.6 percent below their levels of a year earlier.

The more volatile part of the Producer Price Index, crude goods, declined 0.9 percent in October following declines in five of the last six months. Crude materials prices have now declined in seven of the first ten months of 1984 and were actually 1.5 percent below their levels of a year ago this October.

Housing Starts - Privately-owned housing units declined in October to their lowest level since December 1982. New housing starts in October reached an annual rate of 1,515,000, ten percent below the revised 1,679,000 annual rate reported in September. October's housing starts were 9.4 percent below their level a year

ago. In the first ten months of 1984, 1,522,000 housing units were started compared to 1,458,800 for the same period in 1983—an increase of four percent.

Industrial Production - Industrial production remained unchanged in October following a decline of 0.5 percent in September. This places industrial production 6.6 percent higher than a year ago and over 22.5 percent above the November 1982 recession trough. Business equipment production rose 0.3 percent in October, following a 0.1 percent increase in September. This placed business equipment production 16.9 percent above the level of a year ago, more than double the increase in production for the entire index. Production of defense-related goods increased 0.7 percent in October, the largest increase for any market grouping. Consumer goods were manufactured at a 0.2 percent faster pace than reported in September, largely due to a 0.3 percent increase in the production of nondurable goods which was partly offset by a decline of 0.1 percent in durable goods production. The scheduled rebound in auto assemblies from a strike-depressed annual rate of 6.9 million units did not materialize. This was mainly due to the strike at the General Motors Canadian operation which resulted in a tight supply of parts of adequate quality, and reportedly limited new car assemblies for the month. Auto makers had planned to increase the rate of auto assemblies in October back up to 7.9 million units, the rate at which they had been producing prior to the GM strike.

The capacity utilization rate for manufacturing, mining, and utilities declined 0.2 percentage points in October to 81.8 percent despite the fact that there was no change in industrial production for the month. This appears to indicate a continued rise in capacity. Capacity in the third quarter continued to increase as American industry added 0.7 percent to its output capability. This was 2.4 percent above the ability of the American economy to produce goods just one year ago.

Business Costs and Productivity - Private business sector productivity, as measured by output per man-hour of all people, increased at a 2.7 percent annual rate in 1983. Productivity continued its climb in the first half of the year as output per hour rose at a 4.5 percent average annual rate, but slowed to a 0.9 percent annual rate in the third quarter. In the nonfarm business sector productivity fell at a 0.7 percent rate. Manufacturing productivity increased at an eight percent annual rate, indicating a quick pay off on new equipment purchases. In the third-quarter unit labor costs were up 1.6 percent over their year-ago level, but were actually below their first-quarter rate.

Interest Rates - The prime rate, after remaining stable at 13 percent since late June and falling in October to 12 percent, now stands at 11.25 percent. Both short- and long-term interest rates have declined sharply since mid-year. The average decline in short-term rates has been about 190 basis points. In the long-term market, Treasury issues declined about 200 basis points while triple-A corporate bonds were down only about 125 points. Even with these declines rates have generally remained above their January levels. Business loan demand eased at the end of October and was virtually unchanged from its mid-August level. Since July 4th., business loans at large commercial banks have increased at a 2.4 percent annual rate, a sharp deceleration from the 23 percent growth rate experienced during the first half of the year.

Business Failures and Formations - Dun and Bradstreet's Index of Business Failures for October indicates that failures were below the level of October 1983. The business discontinuance index, however, was higher than it was a year ago resulting in more business closures for the month. The latest available data indicates that there were 269,984 new business incorporations in the first five months of 1984, a 9.9 percent increase over the same five month period in 1983. The largest percentage increases in the first five months of 1984 were reported in Georgia, 32.1 percent; Washington, D.C., 31.9 percent; North Dakota, 30.7 percent; Maryland, 28.1 percent; and Virginia, 27 percent. Regionally, the largest percentage increase was reported in New England where new incorporations were up 17.2 percent. If new incorporations continue to increase at the present pace, there should be in excess of 650,000 new incorporations in 1984. This rapid increase in new business incorporations reflects the continued, widespread strength of and optimism in the economy. It also signals a continued rise in employment since new business is our greatest single source of new jobs.

Federal Spending - The "Federal Spending Index," a U.S. Chamber devised measure of the monthly change in federal expenditures, indicates that federal spending increased 5.1 percent in October, the first month of fiscal 1985. Receipts for the month were up 15.7 percent from the same month a year ago due to large increases in personal income and social insurance taxes. Federal receipts for FY1984, were up 11 percent from FY1983, while outlays rose by 5.7 percent, less than half the rate of increase in receipts. This resulted in a \$20 billion drop in the deficit for fiscal 1984 compared to a year ago.

Personal Savings - According to Department of Commerce data, personal savings rose to 6.4 percent of after-tax income in October, as consumers put away all of their income gains for the month. The October

savings rate is quite high by recent standards, showing a continued upward trend compared to 6.3 percent in the third quarter and five percent in third quarter of 1983. Personal saving in 1984 should be about \$40 billion higher than they were in 1983.

Retail Sales - Retail sales declined 0.1 percent in October, following an increase of 1.2 percent in September. October sales were very disappointing remaining below the level reached in June. October sales were 6.7 percent above year-ago levels, before taking into account price changes. This would indicate that retailers, after taking into account inflation, are selling about three percent more merchandise this year than in 1983. With consumer confidence remaining at relatively high levels, and continued growth in incomes and employment, Christmas retail sales this year should be a pleasant surprise to retailers.

Trade Deficit - The trade deficit on a goods and services basis increased to an annual rate of over \$85 billion in the third quarter. This was over five times the trade deficit registered in the third quarter of last year. The deteriorating international trade position of the U.S. is best exhibited by the fact that the deficit for goods and services in 1983 was \$8.3 billion for the year, following surpluses of \$19 billion in 1982 and \$28.0 billion in 1981.

What's Ahead - The composite index of leading indicators, designed to predict future movements in aggregate economic activity, decreased 0.7 percent in October. This follows an upwardly revised 0.6 percent increase in September. The August data was also revised upward turning a previously announced 0.1 percent decline into a 0.1 percent increase. Leading indicators have now declined in three of the last five months, indicating at the very least, a weakening trend in the economy.

U.S. Firms Lead World in Technology Exports

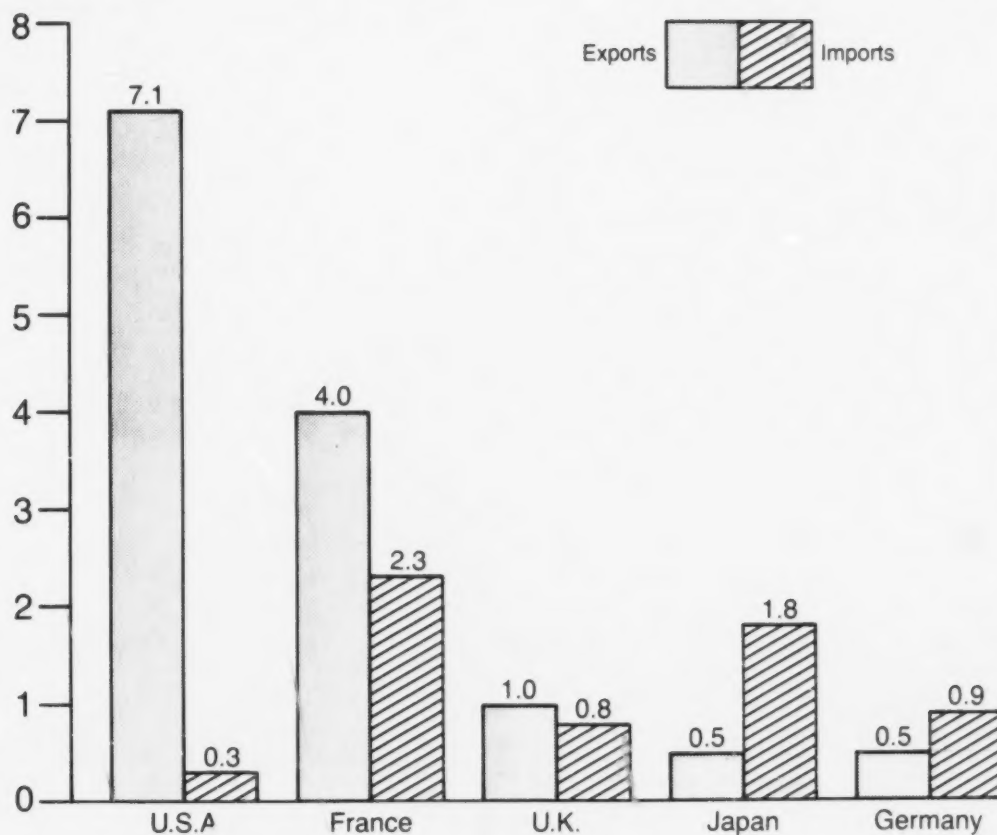
There must be something right going on in American research and development since the rest of the world is pounding at our doors to get the benefits. In 1982, U.S. companies were paid more in royalties to allow foreign firms to use their technology, than were companies in France, the United Kingdom, Japan and Germany combined. This translated into a balance of payments surplus of \$6.8 billion from technology exports. The accompanying chart shows the technology exports and imports of the U.S., United Kingdom, France, Germany, and Japan.

TABLE II
TRENDS IN COMMERCE

	Current Period	Previous Period	Year Ago	Percent Change From Previous Period	Percent Change From Year Ago
Population (Millions)	Sep/84 237.3	237.1	235.1	0.1	0.9
Gross National Product (\$B) [a]	III/84 3,695.2	3,644.7	3,346.6	1.4	10.4
Gross National Product (72\$B) [a]	III/84 1,646.5	1,638.8	1,550.2	0.5	6.2
Money Supply (M1) (\$B) [a]	Oct/84 545.5	548.9	521.7	-0.6	4.6
PEOPLE AND THEIR MONEY					
Personal Consumption Expenditures (\$B) [a]	Oct/84 2,386.2	2,387.9	2,216.6	-0.1	7.7
Personal Consumption Expenditures (72\$B) [a]	Sep/84 1,073.9	1,058.2	1,016.7	1.5	5.6
Disposable Personal Income (\$B) [a]	Oct/84 2,640.1	2,624.8	2,410.3	0.6	9.5
Disposable Personal Income (72\$) [a]	Sep/84 1,180.0	1,174.4	1,106.4	0.5	6.7
Personal Savings Rate (%)	Oct/84 6.4	5.9	5.2	0.5[b]	1.2[b]
Civilian Unemployment Rate (%) [a]	Nov/84 7.2	7.4	8.8	-0.2[b]	-1.6[b]
Average Hourly Earnings [a]	Oct/84 \$8.40	\$8.41	\$8.13	-0.1	3.3
Consumer Price Index (All Urban, 67=100)	Oct/84 315.3	314.5	302.6	0.4	4.2
Purchasing Power of the Dollar (67=\$1.00)	Oct/84 0.318	0.319	0.331	—	—
Prime Interest Rate (%) Nov. 29	Oct/84 11.25	12.0	11.0	-0.75[b]	.25[b]
Retail Sales (billions \$) [a]	Oct/84 107.7	107.9	100.9	-0.1	6.7
BUSINESS PROFITS AND OUTPUT					
Nonfinancial Corporate Profits (\$B)					
Before Tax	III/84 223.7	246.0	227.4	-9.1	-1.6
After Tax	III/84 139.3	150.2	142.6	-7.3	-2.3
Industrial Production (67=100) [a]	Oct/84 165.2	165.2	155.0	0.0	6.6
Capacity Utilization Rate (Mfg.) (%)	Oct/84 82.1	82.2	78.9	-0.1[b]	+3.2[b]
New Housing Starts (thou. units) [a]	Oct/84 1,515.0	1,679.0	1,672.0	-9.8	-9.4
Net Business Formation (67=100)	Sep/84 120.8	119.4	115.8	1.2	4.3
New Business Incorporations (thousands) [a]	May/84 51.2	53.9	50.2	-5.1	1.9
BUSINESS COST					
Unit Labor Costs (nonfarm) (77=100) [a]	III/84 159.4	157.6	155.9	1.1	2.2
Unit Nonlabor Costs (77=100) [a]	III/84 157.8	156.8	149.4	0.6	5.6
Producer Price Indices (67=100)					
Crude Materials [a]	Oct/84 324.0	327.0	329.2	-0.9	-1.6
Intermediate Goods [a]	Oct/84 320.5	320.1	316.2	0.1	1.4
Finished Goods [a]	Oct/84 290.9	291.4	287.1	-0.2	1.3
FEDERAL SPENDING AND DEBT					
Federal Spending Index (67=100) [a]	Oct/84 568.5	540.9	491.6	5.1	15.6
Fed. Gov't Debt Outstanding (\$B)	Jun/84 1,517.2	1,501.7	1,324.3	1.0	14.6
INTERNATIONAL TRADE					
Exports of Goods & Services (\$B) [a]	III/84 369.3	362.4	342.0	1.9	8.0
Imports of Goods & Services (\$B) [a]	III/84 459.2	421.1	358.4	9.0	28.1
Balance on Goods & Services (\$B) [a]	III/84 -89.9	-58.7	-16.4	53.2	448.2
WHAT'S AHEAD?					
Index of Leading Indicators (67=100)	Sep/84 163.8	165.0	162.4	-0.7	0.9
NOTES: [a] Seasonally adjusted data					
[b] Percentage point difference					

EXPORTS AND IMPORTS OF TECHNOLOGY IN MAJOR DEVELOPED COUNTRIES (1982)

(U.S. \$ billion)



U.S. Chamber of Commerce

RECENT INTEREST RATE TRENDS

